

Message Text

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TAGS: EGEN, EAID, CO

SUBJECT: CEPICIES COUNTRY REVIEW-MAY 26-30, 1975

REF: STATE 103839

WE FEEL THAT THE GENERAL ECONOMIC SITUATION AND PROBLEMS ARE ADEQUATELY DEALT WITH IN THE CEPICIES REPORT, WHICH CLOSELY PARELLELS OUR POSITION BOTH WITH REGARD TO THE CURRENT SITUATION AND WITH RESPECT TO PROPOSED FUTURE POLICIES. NEVERTHELESS, WE HAVE PROVIDED MISSION SUMMARY ANALYSIES OF THE PROBLEMS OF DEVELOPMENT STRATEGY, BALANCE OF PAYMENTS, PETROLEUM PRICES, FISCAL REFORM, AND STABILIZATION POLICY. THESE SUMMARIES ARE PRESENTED BELOW:

1. DEVELOPMENT POLICY

THE GOC HAS YET TO PRODUCE A DEVELOPMENT PLAN IN THE SENSE OF A DOCUMENT THAT ELUCIDATES AN OVERALL STRATEGY AND SPECIFIC GOALS OR PROJECTS. NEVERTHELESS THE GOC DOES HAVE A RAHTER CLEAR OVERALL STRATEGY THAT IT HAS BEEN ARTICULATING EVER SINCE THE LOPEZ GOVERNMENT TOOK OFFICE LAST AUGUST. THEIS STRETAGY IS BASED ON A DIAGNOSIS

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CONSISTING OF TWO ELEMENTS. FIRST, IT IS CONCLUDED THAT

THE EXTENSIVE ADMINISTRATIVE CONTROLS PLACED ON THE OPERATION OF THE PRIVATE SECTOR BY GOVERNMENT REGULATION HAVE HAD AN ADVERSE EFFECT ON ECONOMIC GROWTH. THE RESTRAINTS REFERRED TO INCLUDE EXTENSIVE CONTROL OVER THE ALLOCATION OF CREDIT AND THE INTEREST RATES PAID AND CHARGED BY THE BANKING SYSTEM, CONTROLS OVER IMPORTATION, AND EXPLORATION OF COMMODITIES, PRICE CONTROLS ON VARIOUS COMMODITIES, AND EXTENSIVE INVOLVEMENT OF BUREAUCRATIZED GOVERNMENT ENTERPRISES IN PRODUCTIVE SECTORS. THE SECOND ELEMENT OF THE DIAGNOSIS INVOLVES THE REALIZATION THAT SOCIAL OBJECTIVES CAN BE BEST ATTAINED THROUGH SPECIFIC PROGRAMS AIMED AT WELL DEFINED OBJECTIVES. THE EXTENSIVE GOVERNMENT INTERVENTION MENTIONED ABOVE IS DUE IN LARGE PART TO GOVERNMENT PURSUIT OF SOCIAL OBJECTIVES, BUT, BECAUSE THEY APPLIED TO THE WHOLE ECONOMY, THESE OBJECTIVES WERE ACHIEVED (IF INDEED THIS ACTUALLY OCCURRED) AT THE EXPENSE OF ECONOMIC GROWTH. THIS ELEMENT OF THE DIAGNOSIS ALSO INVOLVES THE DETERMINATION THAT THE ACHIEVEMENT OF RAPID ECONOMIC GROWTH WOULD HAVE NO SIGNIFICANT IMPACT ON THE WELL-BEING OF THE POOREST 30-40 PERCENT OF THE POPULATION, WHO WOULD CONTINUE TO LIVE LARGELY OUTSIDE THE MODERN SECTOR. THE GROWTH STRATEGY THAT FLOWS FROM THIS DIAGNOSIS INVOLVES BASICALLY A REDUCTION IN THE LEVEL OF GOVERNMENT INTERFERENCE IN PRODUCTIVE ACTIVITIES, IN ORDER TO SPEED UP THE RATE OF ECONOMIC GROWTH, AND A SHIFT IN EMPHASIS OF GOVERNMENT ACTIVITY FROM THIS GENERAL REGULATORY FUNCTION TO ONE OF DIRECTLY PROMOTING THE IMPROVED WELFARE OF THE POOREST HALF OF THE INCOME DISTRIBUTION--THAT PART OF THE POPULATION THAT MAY BE LEFT BEHIND BY RAPID ECONOMIC GROWTH. THIS STRATEGY SEEMS A CREATIVE RESPONSE

TO THE ACTUAL PROBLEMS OF THE COUNTRY, AND PERHAPS THE MOST EFFECTIVE MEANS OF DEALING WITH SEEKING THE TWIN OBJECTIVES OF RAPID ECONOMIC GROWTH AND IMPROVED WELFARE FOR THE POORER HALF OF SOCIETY. THE GOVERNMENT HAS MADE SIGNIFICANT PROGRESS DURING ITS FIRST NINE MONTHS OF OFFICE IN IMPLEMENTING THE FIRST PART OF THIS STRATEGY. THE BANKING SYSTEM HAS BEEN DECONTROLLED SOMEWHAT WITH LIMITED OFFICIAL USE

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REGARD TO LENDING OPERATIONS, AND INTEREST RATES HAVE BEEN FREED TO A LARGE EXTENT FROM ADMINISTRATIVE CONTROL. SOME PROGRESS HAS BEEN MADE TOWARD ELIMINATION OF PRICE CONTROLS, AND FURTHER PROGRESS TOWARD IMPORT LIBERALIZATION HAS OCCURRED. THE PURSUIT OF THESE OBJECTIVES HAS BEEN HAMPERED BY THE NEED TO DEVELOP A SHORT-TERM STABILIZATION PROGRAM TO FIGHT

INFLATION AND BY THE BALANCE OF PAYMENT DIFFICULTIES THAT HAVE RESULTED PRIMARILY FROM THE RECENT SLOWDOWN OF THE WORLD ECONOMY. NEVERTHELESS, THE RECORD OF THE GOC IN THIS REGARD SEEMS GENERALLY SATISFACTORY, AND OUR EXPECTATION IS THAT IT CAN BE REASONABLY SUCCESSFUL IN CREATING THE CONDITIONS FOR RAPID GROWTH DURING THE NEXT YEAR OR SO. THE GOVERNMENT HAS BEEN MOVING LESS SUCCESSFULLY. HOWEVER, IN ITS PURSUIT OF THE SOCIAL DEVELOPMENT OBJECTIVE. AN OBJECTIVE OF SUBSTANTIALLY IMPROVING THE NUTRITION LEVEL OF THE POOREST HALF OF THE POPULATION HAS BEEN ESTABLISHED, AND VARIOUS MEANS OF ATTAINING THIS OBJECTIVE ARE CURRENTLY UNDER STUDY. THE MOST DEVELOPED PORTION OF THIS PROGRAM PLANS A SERIES OF INTEGRATED DEVELOPMENT PROGRAMS IN RURAL AREAS WITH LARGE CONCENTRATIONS OF SMALL FARMERS. THESE PROGRAMS, TO BE FINANCED LARGELY WITH LOANS FROM THE IBRD AND IDB, WOULD SERVE TO PROVIDE MODERN TECHNOLOGY TO SMALL FARMERS, THEREBY INCREASING THEIR INCOMES, BUT ALSO INCREASING THE FLOW OF BASIC FOOD CROPS TO URBAN CONSUMERS IN PART, THIS INCREASED PRODUCTION OF FOOD WILL BE USED IN SPECIFIC PROGRAMS TO INCREASE NUTRITION LEVELS OF THE URBAN POOR, ESPECIALLY PRE-SCHOOL CHILDREN. THE MAJOR PROBLEM THAT HAS DEVELOPED SO FAR WITH RESPECT TO THE GOC PROGRAM HAS INVOLVED ITS CAPACITY TO MOVE RAPIDLY TO DEVELOP AND ADMINISTER ITS NEW ACTIVITIES. THE GOC IS MOVING MORE SLOWLY THAN WE HAD EXPECTED, AND DEFINITE BOTTLENECKS HAVE OCCURRED, ESPECIALLY IN THE NATIONAL PLANNING DEPARTMENT, BECAUSE OF AN APPARENT LACK OF SUFFICIENT HUMAN RESOURCES. THE GOC SEEMS AWARE OF THESE PROBLEMS, AND WE EXPECT PROGRESS TO BE MADE TOWARD THEIR SOLUTION DURING THE NEXT SIX MONTHS OR SO, BUT THIS SEEMS IN GENERAL TO BE THE WEAKEST LINK IN THE GOVERNMENT'S DEVELOPMENT STRATEGY, AND MAY MERIT SOME EXPRESSION OF LIMITED OFFICIAL USE

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2. BALANCE OF PAYMENTS

AFTER SEVERAL YEARS OF LARGE SURPLUSES, THE BALANCE OF PAYMENTS OF COLOMBIA BEGAN TO TURN NEGATIVE DURING 1974. NET RESERVES REACHED A RECORD LEVEL OF \$576 MILLION IN FEB 1974, BUT HAVE SINCE STEADILY DECLINED TO A LEVEL OF \$350 MILLION IN APRIL, 1975. THIS RESERVE LOSS IS DUE TO LIBERALIZATION OF IMPORTS, RISING IMPORT PRICES AND MORE RECENTLY, DECLINING COFFEE PRICES AND LACK OF FOREIGN DEMAND FOR OTHER COLOMBIAN EXPORTS. OUR EXPECTATION IS THAT BALANCE OF PAYMENTS PROBLEMS WILL PERSIST FOR AT LEAST ANOTHER YEAR, AND THAT RESERVES MAY FALL TO A LEVEL OF \$220 MILLION BY THE END OF THIS YEAR. GIVEN THE WORLD MARKET SITUATION, LITTLE HELP CAN BE EXPECTED IN THE NEAR TERM FROM FASTER EXPORT GROWTH--

THOUGH THE GOC IS MOVING APPROPRIATELY IN THIS DIRECTION THROUGH A SPEEDING UP OF THE RATE OF DEPRECIATION OF THE PESO. SOME ASSISTANCE CAN COME FROM RESTRICTION ON IMPORTS, EVEN THOUGH THIS RUNS IN OPPOSITION TO THE GOC POLICY OF MINIMIZING ADMINISTRATIVE CONTROLS ON FOREIGN TRADE. OUR POSITION IS THAT THE BALANCE OF PAYMENTS PROBLEM IS BASICALLY SHORT RUN, AND THAT MEASURES THAT DISTORT THE PRODUCTIVE STRUCTURE, SUCH AS ADMINISTRATED IMPORT RESTRICTIONS, SHOULD BE USED TO THE MINIMUM EXTENT POSSIBLE. RATHER, THE GOC RESPONSE TO THE PROBLEM SHOULD BE ONE OF RELIANCE ON CAPITAL INFLOWS, BOTH CONCESSIONAL AND COMMERCIAL, TO MEET THE REQUIREMENTS OF THE SITUATION. THE MAJOR POLICY REQUIREMENT FOR THIS POLICY TO SUCCEED IS IT SEEMS TO US FOR THE GOC TO IMPROVE ITS ADMINISTRATIVE MANAGEMENT OF FOREIGN CREDIT. IN THE CASE OF DEVELOPMENT LOANS, THIS WOULD INVOLVE THE SPEEDING UP OF DISBURSEMENT PROCESSES AND OF PROJECT DEVELOPMENT ACTIVITY. A SIGNIFICANT AMOUNT OF PRIVATE FOREIGN CAPITAL INVOLVED IN MAJOR MINERALS PROJECTS IS IN THE SAME SITUATION, WHERE A MORE AGILE SYSTEM OF PROCEDURES IS NEEDED TO SPEED UP DISBURSEMENT. IN BOTH OF THESE AREAS, IT IS OUR OPINION THAT AN INCREASE IN THE RATE OF ACTIVITY BY THE GOC SHOULD PROVIDE BETWEEN \$100 AND \$200 MILLION IN CAPITAL INFLOWS OVER THE NEXT TWO YEARS THAT WOULD BE ADDITIONAL TO WHAT WOULD OCCUR UNDER A CONTINUATION OF THE CURRENT BUREAUCRATIZED PROCEDURES. OVER THE SHORT TERM, SOME ADDITIONAL LIMITED OFFICIAL USE

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E O 11652 NA

TAGS EGEN EAID CO

SUBJ: CEPCIES COUNTRY REVIEW-MAY 26-30/75

BORROWING FROM COMMERCIAL SOURCES MAY BE REQUIRED TO ENSURE CONTROL OF THE BALANCE OF PAYMENTS AND WE WOULD AGREE WITH USE OF SUCH RESOURCES.

3. PETROLEUM POLICY

COLOMBIA'S PRESENT PETROLEUM PROBLEM IS COMPOSED OF TWO RELATED BUT SOMEWHAT SEPARATE ISSUES: (1) THE NEED TO STIMULATE ADDITIONAL PRODUCTION AND EXPLORATION TO COUNTER THE RAPIDLY GROWING RECOURSE TO IMPORTS AND (2) THE NEED TO DEVELOP A POLITICALLY AND ECONOMICALLY ACCEPTABLE FORMULA RELATED TO THE INCREASE IN GASOLINE (AND CONSEQUENTLY MASS TRANSPORTATION) PRICES WHICH WILL BE NECESSARY TOPAY FOR PRODUCTION AND EXPLORATION INCENTIVES.

CRUDE PETROLEUM PRICES AVERAGE US \$1.55 PER BARRELL WITH MOTOR GASOLINE AT 11 1/2 CENTS PER GALLON. THE CRUDE PRODUCTION DECLINE LIMITED OFFICIAL USE

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RATE IS NORMALLY HIGH AND HAS BEEN ACCENTUATED BY PRICE STRUCTURE. FOR THE SAME REASON NEW EXPLORATION HAS PRACTICALLY CEASED. COLOMBIA BEGAN TO IMPORT PETROLEUM IN LATE 74 AND WILL RAPIDLY INCREASE ITS IMPORTS THROUGH AT LEAST 1980. FUEL OIL EXPORTS WILL BE MORE THAN SUFFICIENT TO COVER IMPORTS UNTIL LATE 76.

ECOPETROL ALSO HAS OVER 100 MILLION DOLLARS IN FORN ACCOUNTS (THESE ACCOUNTS AND PETROLEUM TRADE ARE NOT INCLUDED IN BALANCE OF PAYMENTS DATA AND NET RESERVES) AND COULD THEORETICALLY COVER IMPORTS THROUGH LATE 78-- BUT AT THE EXPENSE OF DIVERTING THESE FUNDS FROM URGENT EXPANSION PROJECTS.

THE GOC IS ACUTELY AWARE OF THE NEED FOR PRICE INCREASES AND IS PRESENTLY NEGOTIATING NEW PRICES, COMBINED WITH GREATER STATE PARTICIPATION WITH THE PRIVATE COMPANIES. RESOLUTION OF THIS

PROBLEM IS POSSIBLE DURING THE NEXT SIX MONTHS. GASOLINE PRICES MUST ALSO BE INCREASED TO REDUCE SUBSIDIES OF ROUGHLY FOUR BILLION PESOS (COMBINED CENTRAL GOVT AND ECOPETROL) WHICH WOULD OTHERWISE DOUBLE EACH YEAR. GASOLINE PRICES DIRECTLY AFFECT MASS TRANSPORTATION PRICES, HOWEVER, AND THE LATTER ARE EXTREMELY SENSITIVE POLITICALLY AND ECONOMICALLY. NO MAJOR GASOLINE PRICE INCREASE IS EXPECTED UNTIL 76 AND THE GOC APPARENTLY HOPES THAT NEW TAX REVENUES FROM HIGHER CRUDE AND GASOLINE PRICES WILL BE SUFFICIENT TO COVER INCREASED TRANSPORT SUBSIDIES. (SEE BOGOTA A-45 FOR FURTHER DETAILS.)

THE EXCESSIVE POSTPONEMENT OF PETROLEUM PRICE REFORM IS LARGELY THE RESULT OF POLITIC CONSIDERATIONS. THE GOC FULLY UNDERSTANDS THE PROBLEMS AND IS PRESENTLY SEEKING SOLUTIONS. WE SEE NO POINT IN RAISING THE PETROLEUM ISSUE AT THIS TIME EXCEPT PERHAPS IN SEEKING CLARIFICATION OF GASOLINE-TRANSPORTATION POLICY. ON THE CONTRARY, DISCUSSION OF CRUDE PRICE AND PARTICIPATION POLICY COULD RUN COUNTER TO US INTERESTS BY FIRING UP POSITIONS WHICH WOULD BE DIFFICULT TO ALTER IN SUBSEQUENT NEGOTIATIONS WITH THE PRIVATE COMPANIES.

4. TAX REFORM MEASURES

SHORTLY AFTER TAKING OFFICE THE LOPEZ ADMIN UTILIZED ECONOMIC LIMITED OFFICIAL USE

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EMERGENCY POWERS TO REFORM THE TAX SYSTEM. THE REFORM INCLUDED GREATER PROGRESSIVITY IN INCOME TAX RATES PLUS CAPITAL GAINS AND PRESUMPTIVE INCOME TAXATION, SUBSTANTIALLY HIGHER SALES TAX RATES FOR "LUXURY" ITEMS, PROCEDURES TO REDUCE TAX EVASION AND AVOIDANCE AND THE REDUCTION OF SEVERAL MAJOR SUBSIDIES. AS A RESULT, COLOMBIAN FISCAL PERFORMANCE HAS IMPROVED SUBSTANTIALLY DURING THE FIRST QUARTER OF 75. THE INCREASE IN SALES TAX REVENUES HAS BEEN ESPECIALLY DRAMATIC AND IS ATTRIBUTABLE TO THE NEW RATE SCHEDULE AND TO IMPROVED COLLECTION TECHNIQUES. THE REDUCTION OF THE EXPORT SUBSIDY IN THE FORM OF A TAX REBATE (CAT) WILL ALSO RESULT IN INCREASED NET COLLECTIONS LATER THIS YEAR. ALTHOUGH CURRENT DATA IS UNAVAILABLE ON DECENTRALIZED AGENCY OPERATIONS, THE ELIMINATION OF THE WHEAT SUBSIDY HAS AT LEAST CUT BACK SHARPLY ON CENTRAL BANK CREDITS TO IDEMA WHICH WERE A MAJOR CAUSE OF MONETARY EXPANSION AND INFLATION.

CENTRAL GOVT CURRENT REVENUES WILL PROBABLY INCREASE BY ABOUT 30-35 PERCENT IN 75. WITH INFLATION BEING HELD TO ABOUT A 20 PERCENT INCREASE THIS WOULD MEAN A REAL INCREASE OF ABOUT 10 PERCENT VERSUS VIRTUAL STAGNATION OVER THE PAST SEVERAL YEARS. DECENTRALIZED AGENCY GENERATED REVENUES ARE ALSO EXPECTED TO INCREASE SUBSTANTIALLY AS A RESULT OF INCREASED RATES FOR SERVICES. THE IMPORTANCE OF THIS INCREASED REVENUE GENERATION LIES IN

PERMITTING THE GOVT TO CONTINUE A HIGH LEVEL OF PUBLIC SECTOR INVESTMENT (AND CONTINUING SOME SUBSIDIES OF LOWER INCOME GROUPS) WITHOUT THE NEED TO RESORT TO INFLATIONARY DEFICIT FINANCING LEVELS OF THE PAST SEVERAL YEARS. (SEE BOGOTA A-48 OF MAY 5/75 FOR DETAILS).

WE HAVE NO PROBLEMS WITH THE NEW TAX STRUCTURE. THE REFORMS ADOPTED ARE ALMOST PRECISELY WHAT AID AND INTERNATIONAL AGENCIES HAD IN EFFECT BEEN RECOMMENDING FOR SEVERAL YEARS. THE ONLY POSSIBLY NEGATIVE FACTOR WAS THE PROCEDURE EMPLOYED. BY UTILIZING EMERGENCY DECREE MECHANISMS AND IMPLICITLY REFUSING ANY PARTICIPATION BY THE PRIVATE SECTOR, THE GOC PROBABLY PROVOKED A NEGATIVE REACTION GREATER THAN NEEDED HAVE BEEN. THIS NEGATIVE PSYCHOLOGY REGARDING THE STATE OF THE ECONOMY AND NEW ADMIN POLICY HAS APPARENTLY BEEN A FACTOR IN ACCENTUATING AND PROLONGING THE PRESENT SLOWDOWN.

5. STABILIZATION AND EMPLOYMENT
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THE PRINCIPAL GOC EFFORT TO CONTROL INFLATION HAS BEEN IN THE FISCAL AREA THROUGH REDUCTION OF DEFICIT FINANCING AS INDICATED ABOVE. THE NEW TAX MEASURES THEMSELVES HAVE HAD SOME ANTI-INFLATIONARY IMPACT AND THE LOPEZ ADMIN HAS ALSO INITIATED SOME REORIENTATION OF AGRICULTURE TO INCREASE BASIC FOOD PRODUCTION AND RENEWED EFFORTS TO CONTROL CONTRABAND. PROGRESS IN REDUCING GROWTH IN THE COST OF LIVING INDEX HAS BEEN CONSISTENT ALTHOUGH QUITE LIMITED. THROUGH THE FIRST FOUR MONTHS OF 75 THE INDEX IS UP 9.8 PERCENT VERSUS 11.5 PERCENT IN 74. PROSPECTS ARE REASONABLY GOOD THAT THE GOC WILL ACHIEVE ITS STATED GOAL OF HOLDING THE INCREASE FOR THE YEAR TO 20 PERCENT AS COMPARED WITH 26 PERCENT IN 74.

THE STABILIZATION MEASURES HAVE UNQUESTIONABLY RESULTED IN A SLOWDOWN IN ECONOMIC ACTIVITY AND AN INCREASE IN UNEMPLOYMENT, ALTHOUGH IT IS DIFFICULT TO DEFINE THE PROPORTION ATTRIBUTABLE TO SUCH POLICIES AS OPPOSED TO EXTERNAL ECONOMIC CONDITIONS. NEVERTHELESS, WE FEEL THAT THE ECONOMY IS BASICALLY IN SOUND CONDITION, AND THAT APPROPRIATE POLICIES BY THE GOC CAN RESULT IN A RETURN TO MORE RAPID GROWTH ONCE INFLATION HAS BEEN SLOWED DOWN, ESPECIALLY SINCE THE IMPROVED FISCAL SITUATION SHOULD GIVE THE GOC INCREASED FLEXIBILITY CONCERNING GOVT SPENDING. CONSEQUENTLY WE DO NOT BELIEVE THAT AN EXPRESSION OF CONCERN OVER EMPLOYMENT

AND GROWTH LEVELS WOULD BE APPROPRIATE, SINCE THE GOC HAD LITTLE ALTERNATIVE BUT TO INSTITUTE MEASURES WHICH WOULD ADVERSELY AFFECT THESE AREAS IF IT WISHED TO MEET THE SERIOUS INFLATIONARY PROBLEM.

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